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SPECIAL NOTICE

RELEASED

Release of this report may not be in the best interests of the Government for reasons stated herein.



*REPORT TO THE COMMITTEE
ON GOVERNMENT OPERATIONS
UNITED STATES SENATE*

094837

Approval Of The
Lease And Loan Guarantee
For The Colonial Motor Inn

B-178344

Small Business Administration

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

70-6753
094837

APRIL 8, 1974



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-178344

The Honorable Sam J. Ervin, Jr.
Chairman, Committee on Government
Operations
United States Senate

Dear Mr. Chairman:

Pursuant to your March 12, 1973, request and subsequent discussions with our representative, we have examined the circumstances surrounding the approval of the lease and loan guarantee for a motor inn called The Colonial.

This report contains information, the disclosure of which may be prohibited by the U.S. Code (18 U.S.C. 1905). This statute makes it a criminal offense to disclose, among other things, the "amount or source of any income, profits, losses, or expenditures" of any person or firm.

Release of this report will be made only upon your agreement. In this connection, we want to direct your attention to the fact that this report contains recommendations to the Administrator of the Small Business Administration which are set forth on page 16. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions he has taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report, and the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. Your release of this report will enable us to send the report to the Administrator and the other three committees for the purpose of setting in motion the requirements of section 236.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "James B. Axtell".

Comptroller General
of the United States

C o n t e n t s

	<u>Page</u>
DIGEST	1
CHAPTER	
1	INTRODUCTION 5
	SBA's roles and responsibilities 5
	Project background 6
	Scope of review 7
2	QUESTIONABLE ASPECTS OF LEASE GUARANTEE 8
	Lease guarantee approved without deter- mining affiliation 8
	Propriety of SBA's headquarters approval 11
	Adequacy of the partners' management experience and capital for investment 13
	Status of the lease as of March 1974 15
	Conclusion 15
	Recommendation 16
3	OTHER INFORMATION REQUESTED BY THE COMMITTEE 17
	Loan guarantee 17
	Status of loan as of March 1974 18
	Information regarding District Counsel 18
APPENDIX	
I	Letter dated March 12, 1973, from Chairman of the Senate Committee on Government Operations 21
II	Principal officials responsible for the activities discussed in this report 22

ABBREVIATIONS

GAO	General Accounting Office
SBA	Small Business Administration

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*COMPTROLLER GENERAL'S REPORT TO THE
COMMITTEE ON GOVERNMENT OPERATIONS
UNITED STATES SENATE*

APPROVAL OF THE
LEASE AND LOAN GUARANTEE
FOR THE COLONIAL MOTOR INN
Small Business Administration
B-178344

D I G E S T

WHY THE REVIEW WAS MADE

GAO was asked to investigate and provide a complete report on approval of the lease and loan guarantee for a motor inn called The Colonial in Helena, Montana, by the Small Business Administration (SBA).

This report contains information, the disclosure of which may be prohibited by the U.S. Code (18 U.S.C. 1905). This statute makes it a criminal offense to disclose, among other things, the "amount or source of any income, profits, losses, or expenditures of any person or firm."

FINDINGS AND CONCLUSIONS

SBA is authorized to guarantee rental payments (lease payments) and to make loans to small businesses. An applicant must meet certain requirements to be eligible for lease and loan guarantees. (See pp. 5 and 6.)

Mr. Tim Babcock, who was Governor of Montana from 1961 to 1968, purchased a supper club and lounge, on the east edge of Helena, in late 1969. In 1970 the building housing the supper club and lounge was moved and construction was started on a 121-room motor inn.

Mr. Babcock encountered financing difficulties and as a result discussed with SBA the possibility of

a lease guarantee. A partnership was formed by two of Mr. Babcock's former employees to lease the motor inn from Mr. Babcock. The partnership obtained from SBA a \$4.3 million lease guarantee in July 1971 and a \$350,000 loan guarantee in December 1971. (See pp. 6 and 7.)

Several aspects of SBA's process for reviewing and approving the lease guarantee appear questionable and cast doubt on the validity of the guarantee. (See p. 15.)

Lease guarantee approved without determining affiliation

According to SBA regulations, an applicant must demonstrate that the lessee and lessor are not affiliated. If the lessor has power to control the lessee, the lease guarantee will not be approved because a true lease does not exist.

The SBA Helena District Office should have determined the applicant's eligibility and whether a bona fide lessee-lessor relationship existed. The district director did not make the determination but referred the lessor to SBA headquarters. (See pp. 8 and 9.)

The district director later accepted an SBA headquarters letter to Mr. Babcock's attorney as full clearance on eligibility, even though the letter answered only limited

aspects of affiliation. GAO was told the letter was not intended to supersede the District Office's responsibility for making the decision. (See p. 9.)

Other aspects of affiliation also were overlooked in SBA's eligibility determination. The lessor, Mr. Babcock, loaned each partner \$17,500 for his initial investment. The lessor also was obligated to loan the partnership up to \$200,000 under the loan agreement.

Mr. Babcock had employed both partners as manager and chef of the old supper club. SBA regulations prohibit key employees of an organization from forming a new related business and becoming lessees of the original owner. (See p. 10.)

Propriety of SBA's headquarters approval

A financial analyst and the Chief Underwriter of the Lease Guarantee Division at SBA headquarters recommended in September 1970 that the application be disapproved because the lessees had limited hotel-motel management experience and insufficient equity capital. All funds invested in the partnership were borrowed. (See p. 11 and pp. 13 to 15.)

The Chief Underwriter subsequently recommended that a revised application be disapproved even after SBA officials and the partnership agreed that the partnership would hire an experienced motel manager because a marginal risk still remained. (See p. 12.)

On September 18, 1970, the SBA Asso-

ciate Administrator for Financial Assistance issued a commitment letter for the lease guarantee, although GAO could find no evidence supporting approval of the lease guarantee. (See p. 12.)

Adequacy of the partners' management experience and capital investment

SBA regulations provide that a lease guarantee not be approved unless the lessee has adequate management experience or sufficient capital for investment. The lessees had limited hotel-motel management experience and insufficient equity capital. (See pp. 13 to 15.)

Status of the lease guarantee

In late December 1973, because the lessees were 3 months in arrears in their lease payments, the lessor made formal demand on SBA for the \$18,000 per month lease guarantee payment starting January 1, 1974. As of March 1, 1974, no lease guarantee payments had been made, although SBA may be liable for \$18,000 per month until another lessee is located. (See p. 15.)

Loan guarantee

SBA approved the guarantee on November 24, 1971. Because of certain reservations it had regarding the loan guarantee, SBA established certain conditions as a prerequisite to approval of the guarantee. (See pp. 17 and 18.)

Only three payments were made. SBA, upon the bank's request, on November 26, 1973, purchased its portion of the loan, including

delinquent interest, for about \$351,000. (See p. 18.)

Information regarding District Counsel

The Committee, after the March 12, 1973, letter, requested GAO to obtain information related to the separation from duty of the former District Counsel of SBA's Helena District Office. GAO was also asked to obtain certain information on the activities of the present District Counsel.

GAO found that the former District Counsel signed a statement that he had not been coerced into retirement. He also said that his decision to retire was influenced by certain personal factors. (See p. 19.)

The former District Counsel was retired on May 23, 1970, on the basis of a reduction in force, and a new District Counsel was hired for the same position the next week--May 31, 1970. SBA's Director of Personnel, who assumed his current position in August 1971, could not explain how an individual could be hired for the position one week after the position had been eliminated because of a re-

duction in force. Because it is unusual in a reduction-in-force situation for a position to be re-created within a short time after its abolishment, we are referring this case to the Civil Service Commission with a request that it investigate the correctness of SBA's actions.

GAO also found that the present District Counsel

--did work for the State during Governor Babcock's administration; however, he did not report directly to him but rather through a supervisor and

--reviewed the proposed lease guarantee, although he did not have the authority to approve it. (See pp. 19 and 20.)

RECOMMENDATION

The SBA Administrator should establish procedures to require documentation justifying approval of lease guarantees when SBA operating officials recommend disapproval.

AGENCY ACTIONS AND UNRESOLVED ISSUES

SBA agreed with GAO's recommendation and intends to implement the necessary procedures.

CHAPTER 1

INTRODUCTION

By letter dated March 12, 1973, the Chairman of the Senate Committee on Government Operations requested an investigation and report on the approval of the lease and loan guarantee for a motor inn called The Colonial¹ (including a restaurant, lounge, and convention center), Helena, Montana, by the Small Business Administration (SBA). The Committee subsequently requested that we obtain additional information on the Helena District Counsel's retirement.

SBA'S ROLES AND RESPONSIBILITIES

The Small Business Investment Act (15 U.S.C. 661) was amended in 1965 to authorize SBA to guarantee rental payments (lease payments) by small businesses displaced by federally assisted construction projects or operated by economically disadvantaged persons. The act was further amended in 1967 to include all small businesses.

The lease guarantee program initially did not limit either the amount of lease payment per month or the total amount of the lease which could be guaranteed. SBA established a limitation of \$9 million on individual lease guarantees in September 1969 and subsequently revised its limitation to \$2.5 million in February 1971.

SBA is also authorized under section 7(a) of the Small Business Act (15 U.S.C. 631) to loan small businesses up to \$350,000 for a period of 10 years for conversion of facilities, purchase of equipment, and working capital; loans for plant construction may be made for 15 years. The loans may be direct, participating, or guaranteed. Under the latter, SBA guarantees a bank up to 90 percent of the amount of the loan. The bank may request payment from SBA when the borrower is in default for 90 days.

Eligibility for lease guarantee

To be considered eligible for a lease guarantee, an

¹Subsequently renamed the Colonial Hilton Inn.

applicant must demonstrate that (1) the business qualifies as a "small business" (generally, a business that is independently owned and operated and not dominant in its field and that meets SBA size standards) and (2) a landlord-tenant relationship exists. To ascertain that a bona fide landlord-tenant relationship exists, SBA establishes that an "affiliation" does not exist. SBA defines "affiliation" as the ability of (1) either party to control or have the power to control the other party or (2) a third party to control or have the power to control both parties.

Risk analysis

After eligibility is determined, a risk analysis is made to determine if the lessee can reasonably be expected to meet lease payments. Included in the risk analysis are:

- Financial analysis to determine if the applicant will be able to pay expenses, retire debt, and provide a satisfactory return to the owners.
- Management capability analysis to determine if the applicant possesses the management skills necessary to run the business profitably during the period for which the lease is guaranteed.
- Location analysis to determine the inherent risk in leasing the proposed premises to a specified business. The major thrust of this analysis is to estimate the rent for the particular location and to determine if the proposed business can afford to pay this rent.

PROJECT BACKGROUND

Mr. Tim Babcock, who was Governor of Montana from 1961 to 1968, purchased a supper club and lounge, located on the east edge of Helena in late 1969. Subsequent acquisitions brought the total land held to 14.7 acres.

In 1970 the building housing the supper club and lounge was relocated and construction was started on a 121-room motor hotel, restaurants, lounge, and convention center capable of handling about 500 people. Mr. Babcock had encountered financing difficulties because the original plan to finance the project with a \$1.8 million loan from the

Public Employees Retirement System of the State of Montana did not materialize.

Financing arrangements were discussed with SBA officials in June 1970 and it was determined that a lease guarantee could be obtained from SBA if a proper lessee-lessor relationship could be established. Mr. Alfred Bohley (head chef) and Mr. William Kuney (manager and son-in-law of Mr. Babcock) formed a partnership on July 1, 1970 to lease the premises.

SBA issued the partnership a lease guarantee commitment letter for about \$4.3 million on The Colonial motor inn in September 1970. Construction was completed in 1971 and the lease guarantee became effective July 1, 1971. The lease requires the lessee to make 240 monthly payments of \$20,461 each, and the lease guarantee requires SBA to make monthly payments of \$18,000 for the remainder of the lease if the lessee fails to make lease payments. Because the commitment letter was issued before April 1, 1971, the lease guarantee did not fall within the current regulation limitation on the amount of monthly and aggregate lease payments guaranteed by SBA.

In addition, SBA guaranteed a \$350,000 loan, under its business loan program, to the partnership on December 20, 1971. The loan was to furnish working capital to the partnership. The loan, at 8-3/4 percent interest, called for monthly payments of \$5,590 for 7 years.

SCOPE OF REVIEW

We reviewed the legislation, regulations, policies, and procedures pertaining to SBA's lease and loan guarantee programs and the lease and loan files at SBA's Helena District Office and Washington, D.C., headquarters office.

We discussed the project with (1) SBA officials in Washington, D.C., and Helena, (2) former SBA employees, (3) one of the partners, (4) a bank official in Helena, and (5) the lessor. Also, we visited the motel in Helena.

CHAPTER 2

QUESTIONABLE ASPECTS OF LEASE GUARANTEE

Contrary to its standard operating procedures, SBA did not determine whether the lessee and the lessor were affiliated i.e., whether the lessor had control over or the ability to control the lessee. SBA's regulations preclude approval of a lease guarantee when affiliation exists. Despite recommendations by SBA headquarters personnel that the lease guarantee be disapproved because of unsubstantiated market potential, inadequate financing, and questionable managerial ability, SBA's Associate Administrator for Financial Assistance¹ approved a commitment letter for the lease guarantee. Our review of SBA's files and records showed no documentation of why headquarters personnel were overruled.

LEASE GUARANTEE APPROVED WITHOUT DETERMINING AFFILIATION

According to SBA regulations, an applicant for a lease guarantee must demonstrate, among other matters, that an affiliation does not exist. If the lessor has the power to control the lessee, an application will not be approved because a true lease cannot exist.

In June 1970, the lessor met with the Director of SBA's Helena District Office to discuss the eligibility of the proposed lease guarantee. It was pointed out that a father/son-in-law relationship existed and the question was raised as to whether this relationship precluded approval of the lease guarantee.

Although SBA's standard operating procedures require that district offices decide the question of eligibility, the District Director stated that he did not want this responsibility and suggested that the lessor discuss the father/son-in-law relationship with SBA headquarters officials.

¹ The Associate Administrator for Financial Assistance in office at that time resigned in January 1973. (See app. II.)

On June 18, 1970, the lessor's attorney wrote a letter to SBA headquarters asking, among other things, if the father/son-in-law relationship would preclude SBA from guaranteeing a lease.

On June 26, 1970, the Acting Chief of the Lease Guarantee Division wrote a letter to the lessor's attorney saying:

"The fact that Mr. Kuney [one of the lessees] is the son-in-law of Mr. Babcock [the lessor], nothing else appearing as an indication of affiliation, poses no problem * * *."

The June 26, 1970, letter was carried to the SBA Helena District Office. The District Director accepted it as full clearance on the question of affiliation despite the fact that the letter answered only the father/son-in-law relationship. The letter did not question the extent to which the lessor could control the lessee. Also the letter was addressed to the lessor's attorney and not to the SBA District Office Director, who was responsible for determining if an affiliation existed.

The District Director told us that he thought the letter was meant as a clearance on the affiliation question and accordingly took no further action. The District Counsel told us that he had some personal reservation about the possible affiliation of the lessor and one of the lessees, but he was never specifically asked to make a determination.

The Acting Chief of the Lease Guarantee Division told us that the June 26, 1970, letter

--was intended only to answer the father/son-in-law relationship question and

--was not intended to supersede the District Office's responsibility for making the affiliation determination.

The Acting Chief stated that the letter was addressed only to a person outside of SBA and was worded to indicate its limited nature. He also told us that he thought the affiliation question had been resolved at the District Office.

Other factors which should
have been considered in
determining affiliation

Our review of the lease guarantee file and discussions with involved individuals revealed several facts which were available to SBA personnel when the lease guarantee was being reviewed. SBA should have considered these facts in making its affiliation determination.

SBA regulations state that:

"In determining whether concerns are independently owned and operated and whether or not affiliation exists, consideration shall be given to all appropriate factors, including common ownership, common management, and contractual relationship."

Certain facts cast doubt on the lessee-lessor relationship. For example:

1. The partnership agreement called for an equal investment by each of the partners. The loan agreement called for a total investment of \$35,000. Both partners, however, obtained this capital as a loan from the lessor.
2. Under the terms of the loan agreement, the lessor was to loan the partnership up to \$200,000.
3. Prior to construction of The Colonial motor inn in 1971, prospective lessees were employed by the prospective lessor as manager and chef of the old supper club and lounge. SBA regulations prohibit key employees of an organization from forming a new related business and becoming lessees of the original owner. Apparently, the lessees could have been considered key employees of the old supper club and lounge.

Although the father/son-in-law relationship described on pp. 8 to 10 may not constitute affiliation, the question of control becomes suspect in light of these additional facts.

PROPRIETY OF SBA'S HEADQUARTERS APPROVAL

The application for the lease guarantee was recommended for approval by both the Helena District Office Director and the Denver regional office and was received at SBA's headquarters office in August 1970. A financial analyst and the Chief Underwriter of the Lease Guarantee Division reviewed the application and recommended that it be disapproved for the following reasons:

- Management was inexperienced in operating a business of the type and size contemplated.
- Capitalization for this size facility was totally inadequate.

In addition, the Chief Underwriter believed the lease payment was too high and the market projections might be unattainable.

SBA's Associate Administrator for Financial Assistance reviewed the application and met with the prospective lessor in Washington, D.C., on September 14, 1970, and discussed the proposed lease. Usually the lessee is responsible for obtaining approval of the proposed lease guarantee. According to SBA officials, the lease guarantee program is designed to primarily help the lessee obtain adequate business space; the benefits that may accrue to the lessor by leasing his space and obtaining adequate financing are secondary considerations.

On the basis of this meeting, the proposal was modified as follows:

- The rent was reduced from \$23,600 to \$20,461 per month, and the lease term was extended from 15 to 20 years.
- The guarantee requested was reduced from \$20,753 to \$18,000 per month, and the term was extended from 15 to 20 years.
- Some evidence of potential convention business was presented.

- The lessor agreed to loan the lessee up to \$200,000 with principal payments deferred until the third year.
- The partners agreed to hire an experienced motel manager.

Even after the modifications, on September 16, 1970, the Chief Underwriter recommended that the application be disapproved because a marginal risk still remained.

On September 18, 1970, the Associate Administrator for Financial Assistance issued a commitment letter for the lease guarantee.

Our review of SBA's files and discussions with appropriate SBA personnel did not show the reasons why the Associate Administrator overruled the Chief Underwriter and approved the lease guarantee.

We discussed the matter with the Associate Administrator for Financial Assistance who said a meeting was held after September 16, 1970, the date of the Chief Underwriter's second letter recommending disapproval. He said the decision to approve the lease guarantee application represented the views of those who attended the meeting. He thought that SBA's Lease Guarantee Division's Acting Chief, Chief Underwriter, and financial analyst attended the meeting.

We interviewed the three individuals and none of them could remember having attended such a meeting. We failed to locate any record of such a meeting in the lease guarantee files at SBA headquarters.

ADEQUACY OF THE PARTNERS' MANAGEMENT
EXPERIENCE AND CAPITAL FOR INVESTMENT

SBA regulations state that a lease guarantee should not be approved if, among other matters, the lessee does not have adequate management experience or sufficient capital for investment. Our review showed that the lessees had limited hotel-motel management experience and insufficient equity capital.

The Small Business Investment Act states that:

"No guarantee shall be issued * * * unless the Administration determines that there exists a reasonable expectation that the small business concern in behalf of which the guarantee is issued will perform the covenants and conditions of the lease."

SBA accordingly evaluates the management capability and financial position of each lease guarantee applicant. (See p. 6.) According to SBA, management capability is a key factor in appraising the potential success of a business because other factors considered will be conditioned by the manager's degree of skill. Financial position is a critical index in determining if a lease should be guaranteed.

Management

Information contained in SBA's lease guarantee file showed that:

- One partner had 1 year's experience as manager of a supper club owned by the lessor, 7 years' experience as an auditor for the State of Montana Examiner's Office, and 4 years' experience as a retail-wholesale salesman for a dairy products distributor. He was to be general manager of The Colonial motor inn.
- The second partner had over 20 years' experience as an executive chef in various hotels, but he had no experience in hotel-motel operations other than in food preparation and service. This partner was to be the food and beverage director of The Colonial motor inn.

As indicated on page 11, officials of SBA's Lease Guarantee Division also had reservations as to the partners' management capability.

On September 2, 1970, a financial analyst of the Division, in reviewing the proposed lease guarantee, stated that both partners had limited experience in motel management and that there was no evidence to indicate that the necessary executive experience was available to run such a large complex to insure profitable operation.

On September 4, 1970, the Chief Underwriter of the Division stated in his report that the proposed management was inexperienced in operating this kind of facility. SBA officials and the lessor subsequently met on September 14, 1970, and agreed that the partnership would hire an experienced motel manager.

Although the Chief Underwriter indicated on September 16, 1970, that hiring an experienced motel manager might strengthen the enterprise, he recommended that the lease guarantee be declined because the enterprise still remained a marginal risk.

Investment capital

Personal balance sheets submitted in connection with the lease guarantee application showed that the partners had individual net worths of \$39,300 and \$9,300.

Neither partner had any personal funds invested in the partnership. All funds invested were borrowed.

One partner told us that he borrowed the initial investment capital (\$17,500) from the lessor, his father-in-law. The lessor told us that he also loaned the second partner the initial investment capital of \$17,500. The partnership obtained financing of \$169,000 from the lessor by means of three notes dated in September and December 1971.

The partnership applied for an SBA loan guarantee on November 1, 1971, and SBA approved the loan guarantee on November 24, 1971, for 90 percent of \$350,000. One of the collateral conditions was a personal guarantee by the lessor, secured by a second lien on the motel property.

An additional \$125,000 was obtained in December 1970 or January 1971 as a bank loan by the partnership on which the lessor gave his personal guarantee.

STATUS OF THE LEASE
AS OF MARCH 1974

The lease guarantee agreement provided for payment of \$18,000 a month for the remainder of the 240 month lease agreement. In late December 1973, because the lessees were 3 months in arrears in their lease payments, the lessor made formal demand upon SBA for the \$18,000 per month lease guarantee payment starting January 1, 1974. SBA may be liable for \$18,000 per month until another lessee is located. SBA may be liable for the difference between the guaranteed amount and the amount the lessee is willing to pay, if the new lease payment is below \$18,000 per month.

CONCLUSION

Several aspects of SBA's review and approval process for the lease guarantee appear questionable and cast doubt on the validity of the lease guarantee for The Colonial motor inn.

SBA, contrary to its regulations, did not determine if the lessor had control or the ability to control the lessee. Also, two officials in SBA's Lease Guarantee Division recommended disapproving the lease guarantee and expressed concern about the lessees' management ability and initial capital investment. One of the above officials, the Chief Underwriter of SBA's Lease Guarantee Division, considered the lease guarantee a marginal risk.

SBA files on The Colonial motor inn lease guarantee and discussions with responsible SBA officials in the Helena District Office and SBA headquarters did not show any valid reason for approval of the lease guarantee by SBA's Associate Administrator for Financial Assistance. We found no documentation in SBA's files indicating why the Associate Administrator overruled his subordinate's written recommendation for disapproval. SBA rules and regulations do not require documentation justifying the approval of a lease guarantee when SBA operating officials recommend disapproval.

RECOMMENDATION

We recommend that the Administrator of SBA establish procedures to require documentation justifying approval of all lease guarantees when SBA operating officials recommend disapproval.

SBA officials were given the opportunity to review the report. They advised us that they agreed with the contents of the report. Also they agreed with our recommendation and intend to implement the necessary procedures.

CHAPTER 3

OTHER INFORMATION REQUESTED BY THE COMMITTEE

LOAN GUARANTEE

Although they had some reservations, SBA Helena District Office officials approved the loan guarantee of \$350,000 on November 24, 1971. Certain conditions, however, were established by SBA as a prerequisite to approval of the guarantee.

The application for the loan guarantee was received at SBA's Helena District Office on November 5, 1971. The district office's loan officer and director reviewed the application and made the following comments on the proposed loan:

- The working capital was barely adequate to support the volume of business projected by the applicant.
- The general financial condition was unbalanced and adverse. The applicant had \$6.30 borrowed for every \$1 of equity money and had no resources from which to raise additional equity.
- The management capability was just average.
- The loan could be considered as protection for the existing lease-guarantee commitment as well as request for funds from an eligible small business.
- The loan request did not conflict with basic SBA statutory policies, such as the limitation on size as defined in the Small Business Act, as amended, and ineligibility of certain businesses (i.e., newspapers, speculators, or gambling).

The District Director approved the loan guarantee under the following conditions:

- The partners would invest not less than \$35,000.
- Mr. Babcock would give his personal guaranty by a lien on realty, subject only to prior liens totaling \$2 million.

- The partners would obtain a loan of at least \$100,000 for working capital from the lessor.
- The partners would agree not to incur additional indebtedness without prior consent of the bank and SBA.
- The standard loan conditions would include fixed asset limitations and salary limitations.

STATUS OF LOAN AS OF MARCH 1974

The loan guarantee provided for 82 monthly payments of \$5,590 each. SBA records show that only three loan payments were made. SBA, upon the bank's request, on November 26, 1973, purchased its portion of the guaranteed loan, including delinquent interest, for about \$351,000.

INFORMATION REGARDING DISTRICT COUNSEL

After we received the Chairman's March 12, 1973, letter, the Committee requested us to obtain information related to the separation from duty of the District Counsel of SBA's Helena District Office. This separation occurred in May 1970--approximately the same time as The Colonial motor inn lease application was submitted.

Specifically, we were to look into whether:

1. The District Counsel was ordered transferred to Alaska because he twice rejected the lease guarantee application and resigned rather than accept the transfer.
2. The District Counsel's successor formerly held a position as Counsel in the Montana Highway Department during Mr. Babcock's tenure as Governor of Montana.
3. The District Counsel's successor approved The Colonial motor inn lease guarantee application shortly after being appointed as the SBA Helena District Office Counsel.

We discussed the first allegation with the former Helena District Office Counsel and he said he had never rejected the lease guarantee proposal. He stated that it had not

been submitted before he left SBA, although it was common knowledge in Helena that Mr. Babcock was considering applying for a lease guarantee for The Colonial motor inn. He also stated that he was given a transfer notice because he had let it be known that, if the project was submitted for approval, he would reject it.

We reviewed the former District Counsel's retirement papers and noted that he signed a statement that he had not been coerced into retirement. He told us that his decision to retire was influenced by the fact that his wife had suffered a stroke, was confined to a hospital, and was expected to require an extensive recovery time. He felt that he could not move under those circumstances and accordingly applied for retirement. He was retired on May 23, 1970, on the basis of a reduction in force.

The retirement papers showed that the former District Counsel resigned during a reduction-in-force situation and was retired on the basis of an involuntary separation. It should be noted, however, that a new District Counsel was hired for the same position the next week--May 31, 1970.

SBA's Director of Personnel, who assumed his current position in August 1971, could not explain how an individual could be hired for the position of District Counsel 1 week after the position had been eliminated because of a reduction in force. Because it is unusual in a reduction-in-force situation for a position to be re-created within a short time after its abolishment, we are referring this case to the Civil Service Commission with a request that it investigate the correctness of SBA's actions.

In relation to the second allegation, we held discussions with the present District Counsel about his relationship with the ex-Governor at the time he was working for the State. He was hired as Chief Counsel of the Montana State Highway Commission in January 1961 by Governor Babcock's predecessor and remained in that office during Governor Babcock's administration. He told us that he was not, nor is he now, a close friend of the ex-Governor. He said that when he worked for the State of Montana at no time did he report directly to the Governor but rather had to report through a supervisor.

Information follows on the third allegation--that one of the first official acts of the new District Counsel was to approve the lease guarantee application.

SBA policies for the lease guarantee program require that the District Counsel review proposed lease guarantees and all related documents. Although one of the new District Counsel's first official acts was to review and approve the application, he did not give final approval to this project but rather approved only its legality, based on the supporting documentation.

Final approval of this lease guarantee application was made in the Washington, D.C., central office on September 18, 1970, by the then Associate Administrator for Financial Assistance because only the central office has the authority to approve a lease over \$1 million.